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The Effects of the Financial Crisis on Systemic Trust

CEPS Working Document No. 316/July 2009

Felix Roth

Abstract

The financial crisis had a significant impact on the levels of trust that citizens place in the system and its institutions. Recent data from Eurobarometer show a significant fall in confidence on the part of European citizens in the EU's institutions. For the first time since its creation, a majority of European citizens no longer trust the European Central Bank. However, confidence levels in national governments have actually risen, supporting a contrasting trend between confidence levels in European and national institutions. This decrease in confidence towards the ECB is flanked in the case of Germany by strong anti-capitalist sentiments and a sharp decline in support for the social market economy.

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THE EFFECT OF THE FINANCIAL CRISIS ON SYSTEMIC TRUST

CEPS WORKING DOCUMENT No. 316/JULY 2009

FELIX ROTH*

The collapse of Lehmann Brothers in mid-September 2008 had an enormous impact on the financial markets and the global economy by undermining trust – trust in counterparties among banks and trust in the overall stability of the financial system, but also citizens' trust in their institutions – systemic trust – and the validity of the underlying principles. It is thus not surprising that re-establishing trust in the financial system has become a key task for policy-makers throughout Europe (and the US). This paper aims to contribute to the ongoing discussion of the impact of the financial crisis on trust by presenting recent empirical results concerning the reaction to the crisis as reflected in citizens' diminished levels of systemic trust. Within the paradigm of systemic trust, special attention is given to the confidence invested in: i) political institutions at European and national level and ii) the free market economy.

The paper is divided into five sections. Section 1 briefly elaborates on the key role of systemic trust and cites some basic figures concerning public demand for more state intervention. Using time series data¹ from the public opinion monitoring unit of the European Commission (Eurobarometer), section 2 demonstrates the consequences of the financial crisis on public opinion vis-à-vis the three major European institutions: the European Central Bank, the European Commission and the European Parliament. Section 3 examines the relationship between European and national institutions using time trend data on trust towards national governments and national parliaments from Eurobarometer and the Edelman Trust Barometer. Section 4 shows cross-country results for the five largest European economies and the US and time trend data for Germany to demonstrate how the confidence levels in social market economies per se have been falling after the financial crisis. Section 5 offers conclusions.

1. The key role of sufficient levels of systemic trust

Social scientists from all fields agree that a *sufficient* level of trust, especially systemic or institutional trust, plays a crucial part in the stability and maintenance of the social, political and economic system. When trust breaks down, the social system is threatened with unrest, the democratic legitimacy of the political system is endangered and the legitimacy of the market-based economy is called into question. The latter should be mentioned in particular. Citizens' loss of confidence in a market-based economy is often expressed in one of two ways. They pressure the government to either abolish the free-market system altogether or to intervene more heavily in the system. The likelihood of the first scenario materialising is rather small, as polls

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¹ Raw data available on CD-ROM from Gesis ZA Data Service for Standard Eurobarometers 51-62 (Gesis 2005a, 2005b) and received on request from Gesis ZA Data Service for Standard Eurobarometers 63-69 (<http://www.gesis.org/en/services/data/survey-data/eurobarometer-data-service/data-access/>). Data for the Standard Eurobarometer 70 were taken from Eurobarometer (2008 and 2009b). Aggregated data for the EU27 for the Standard Eurobarometer 71 were taken from Eurobarometer (2009a).

taken in world's largest economies indicate that a majority of citizens are still content with a market-based economy. In some economies, however, notably *Germany*, anti-capitalist sentiments are growing stronger (FT/Harris Poll, 2008 and Institut für Demoskopie Allensbach, 2008). According to a GlobeScan (2008a) survey conducted in May-August 2007, a significant decrease in the confidence in free market economies had started as early as 2002 in Germany, the US, the UK and the emerging economies.

The second scenario in fact is more realistic, as evidenced by increasing calls for stronger state intervention. Citizens want more state intervention at the national and regional level and less integration of their economies in a more globalised context. Recent polls suggest that globalisation is seen as a threat by citizens throughout the world. According to the Edelman Trust Barometer (2009) conducted in January 2009, for instance, 65% of the all respondents (a figure that rises to 84% in France) agreed that their government should impose stricter regulations and greater control over businesses in all industries. According to an FT/Harris poll from mid-October 2008, 81% of Italian, 70% of German, 68% of French and 59% of British respondents support increased regulation by their governments of businesses activities. Citizens had expressed strong fears about globalisation even before the financial crisis. A GlobeScan (2008b) survey conducted shortly before the financial crisis erupted indicated that a majority (72%) of respondents in 23 countries were in favour of measures to protect jobs and national industries, and 63% overall favour restricting foreign ownership of national companies. And according to an FT/Harris poll (2009) in March 2009, already more US citizens tend to agree (30%) than to disagree (24%) that national protectionism is the correct instrument to end the economic recession.

2. Has the financial crisis undermined citizens' levels of confidence? Evidence from Eurobarometer

One of the crucial research questions emerging from the ongoing crisis is how strongly the crisis is affecting European citizens' level of confidence in various institutions. The collapse of the financial sector has made European citizens aware of the fact that capitalist systems are more fragile than they believed they were. But what is the concrete impact on their trust in European and national institutions? Time trend data on confidence levels are still scarce, but one possible source are the survey findings released by Eurobarometer (EB) on the European and national institutions. Thus, to answer the important question on the evolution of European citizens' confidence levels, time series data from EB have been utilised to show the trend in trust for the EU15 and starting in spring 2007, for the EU27 regarding:

- i) the European Central Bank (ECB),
- ii) the European Commission (EC) and
- iii) the European Parliament (EP).

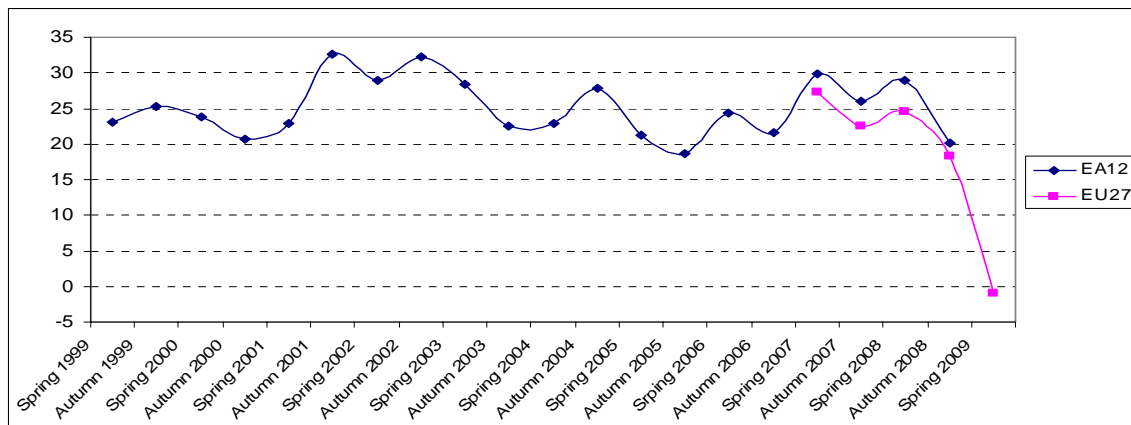
Figure 1 shows the time trend in net levels of trust² in the European Central Bank for the 12 member states of the eurozone.³

² In order to control for the significant variations in the "Don't know" answers, net trust values are given in this paper when using EB data. 'Net trust' here looks only at those respondents who have an opinion and subtracts the percentage of those who say they do not have trust from those who say they have trust in the system. Thus a value above zero indicates that overall there are more people who trust than distrust and a value below zero indicates that the majority of people distrusts.

³ The question of confidence in the ECB is really only relevant in the case of those countries that have implemented the euro. Therefore, only data from the euro area member states (EA12) have been used.

The two last observations in Figure 1 were gathered after the financial crisis. Interestingly, in the autumn 2008 (October-November 2008) poll (Standard EB 70), one month after the financial crisis first hit, the erosion of European citizens' confidence levels in the ECB was still rather modest, whereas by January-February 2009 (Standard EB 71), the decline in confidence in the ECB reached an historically low level in the EU27.⁴ For the first time since the creation of the ECB, more European citizens tend to mistrust the ECB than to trust it. One has to underline here that the ECB is directly relevant for the citizen's in the EA12 countries, as their national central banks have given up their autonomy to this institution. We now have to wait for the results of the Standard EB 72 to know if this trend will continue as sharply as in the interval between Standard EB70 (October-November 2008) and Standard EB71 (January-February 2009) or whether it comes to a halt. One last remark on the interpretation of the data is necessary. The actual confidence levels in the ECB with a net value of -1% is still higher than the confidence levels in national governments and parliaments with net values ranging from -27% to -24%.

Figure 1. Net trust in the ECB in the EA12 (EU27), 1999-2009



Data source: Eurobarometer, Standard EB Nos. 51-71

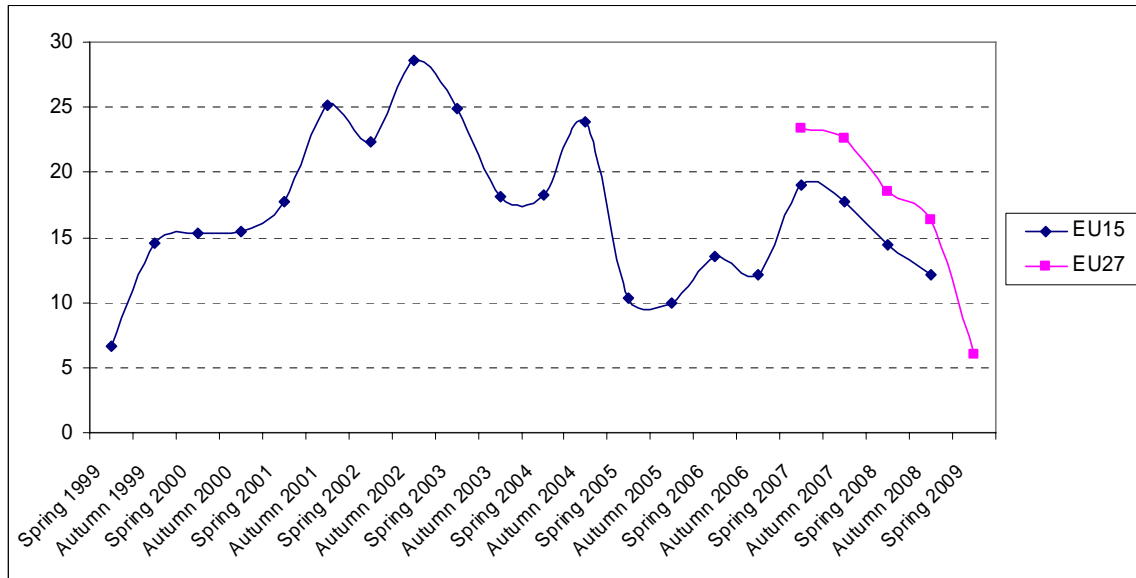
To analyse whether this trend is also applicable to other European institutions, Figure 2 shows the trend in net confidence towards the European Commission. Although the decrease in confidence towards this institution has not been as significant as that towards the ECB, it clearly supports the argument that there is a general decrease of citizens' confidence towards the European institutions since the financial crisis in mid-September 2008. More concretely, the decrease in October-November 2008 was followed by a stronger decrease in the confidence levels in January-February 2009 for the EU27. In contrast to the results discussed above, the levels of confidence in the European Commission are still slightly higher than the ECB. However, citizens' confidence has reached the same low level as it did in spring 1999 a decade ago and might reach its lowest confidence level in autumn 2009, once the data from the next

However, the results do not differ significantly when using an EU15 or EU27 country sample. As the time trend from 1999-2009 is of primary importance in Figure 1, the four new countries Slovenia, Cyprus, Malta and Slovakia that joined the euro area recently have not been included in constructing the average.

⁴ Construction of the average for the EA12 countries from the Standard EB 71 (January-February 2009) is not yet possible as the data have not yet been officially released. Up to now only the aggregated data for the EU27 have been published in the Analytical Summary of the Eurobarometer poll on "European Elections 2009" (Eurobarometer, 2009a).

Standard Eurobarometer can be evaluated. Again one should note that these confidence levels are still significantly higher than the confidence expressed in the national governments.

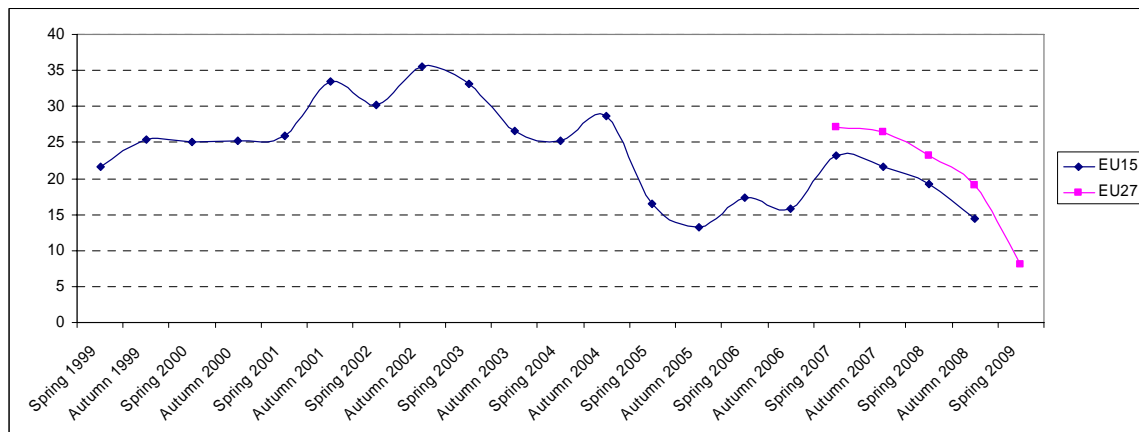
Figure 2. Net trust in the European Commission in the EU15 (EU27), 1999-2009



Data source: Eurobarometer, Standard EB Nos. 51-71.

To get the full picture of the trends in confidence levels towards the European institutions, Figure 3 shows net confidence levels in the European Parliament for the last decade. In a similar pattern to that observed with the ECB, the confidence level in the EP has reached an historical low with a net trust value of 8% in January-February 2009 on the part of the EU27.

Figure 3. Net trust in the European Parliament in the EU15 (EU27), 1999-2009



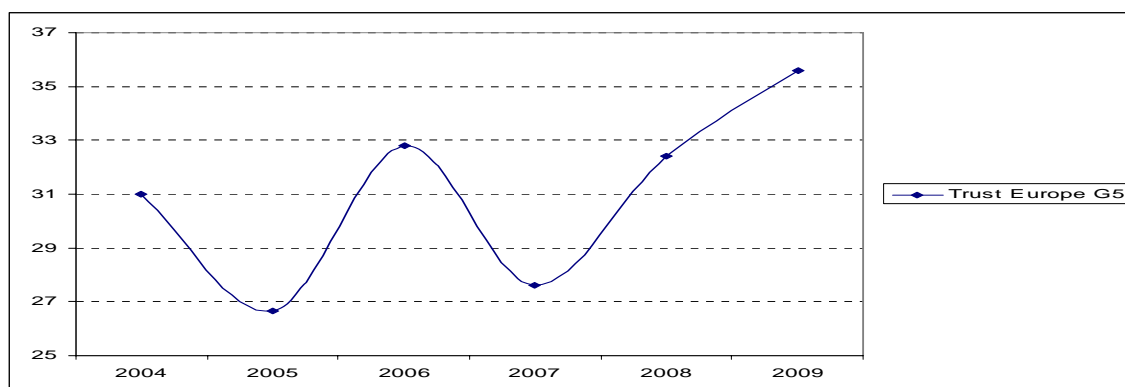
Data source: Eurobarometer, Standard EB Nos. 51-71.

3. How did the financial crisis affect confidence in the national governments?

The interesting question that now arises is whether this strong decrease in confidence levels in European institutions is accompanied by a similar pattern of declining confidence in national institutions.

Two different sources of data are utilised to answer this question. One source is the set of time trend data taken from the Edelman Trust Barometers.⁵ Respondents were asked how much they trusted the government to do what is right. Figure 4 shows the average time trend for the five European countries Germany, France, Italy, United Kingdom and Spain. According to the Edelman Trust Barometers trust in national government actually increased from 2008 – before the financial crisis – to November-December 2008 – after the financial crisis. In particular, the increases in Germany (from 27% to 35%) and the increases in the United Kingdom (from 34% to 41%) in the confidence in the government were rather strong. This phenomenon is not precisely new as empirical evidence suggests that trust in the national government appears to increase after the occurrence of a national crisis. This could already be observed after the attacks on the United States in September 2001 (Chanley, 2002).⁶ In times of severe crisis, citizens' confidence towards their national institutions seems to increase. However, one has to remark that, in contrast to the experiences of the five big European economies, there were significant decreases in levels of public trust, from 39% before to 30% after the crisis, in the United States.

Figure 4. Trust in the national government on the part of European G5 counties, 2004-2009



Data source: Edelman Trust Barometers, 2004-2009.

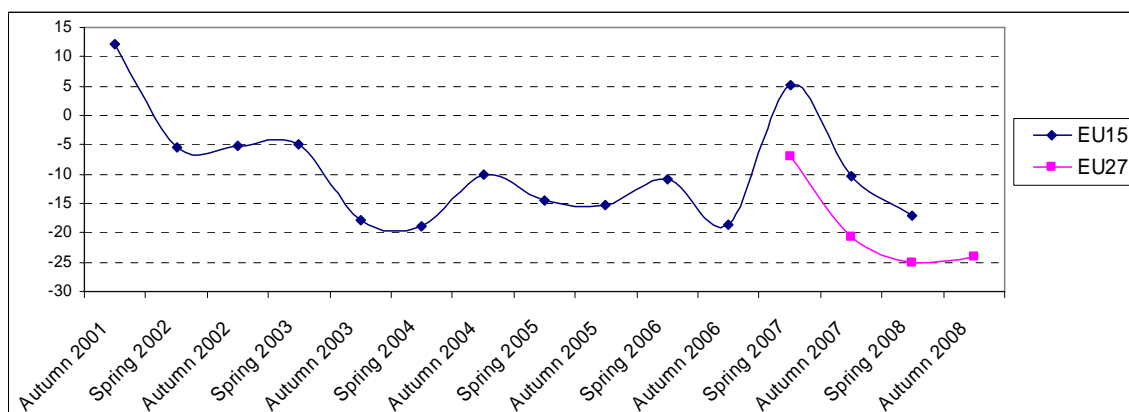
Thus, the Edelman data suggest that the trend seems to be diametrically opposed to confidence towards the European institutions. But is this trend supported by evidence from Eurobarometer? Recent data from Eurobarometer seem to support an inverse relationship between confidence in European institutions and national institutions. The best analysis for testing the assumption is to compare the same institution, in this case the parliament, on a European and national level. Thus

⁵ Data from the 2004 to 2009 period are provided by the Edelman Trust Barometer reports which can be downloaded at <http://www.edelman.co.uk/trustbarometer>. Unlike the Eurobarometer surveys, the Edelman Trust Barometer surveys are not based on a representative sample of the population but are purposely constructed to monitor opinions of 'elites'. Therefore, the Edelman Trust Barometer population is college-educated and reports a household income in the top quartile of their country.

⁶ Although the September 11 attacks were not of an economic character, but rather were general attacks on the US, these figures might nevertheless give some indication of the trend in government confidence in the aftermath of national crisis.

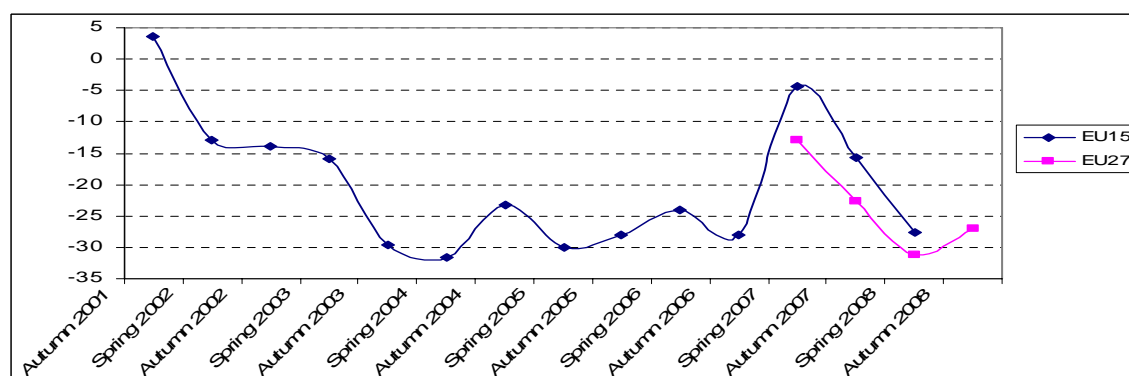
Figure 5 shows the time trend data from Eurobarometer from 2001 to 2008⁷ for citizens' net confidence in national parliaments. Similarly to the Edelman data, one can observe an increase in confidence in the EU27 in the national parliaments after the financial crisis in October-November 2008.

Figure 5. Net trust in national parliaments for EU15 (EU27), 2001-08



Data source: Eurobarometer, Standard EB Nos. 56-70

Figure 6. Net trust in national governments for EU15 (EU27), 2001-2008



Data source: Eurobarometer, Standard EB Nos. 56-70

But does this relationship also hold for confidence in other national institutions? Also utilising Eurobarometer data, Figure 6 plots data showing trends in confidence towards national government. In examining the time trend data on confidence in national governments from 2001-08, shown in Figure 6, one detects a significant increase in the EU27. Thus data from the both Eurobarometer surveys as well as the Edelman Trust Barometer support a diametrically opposed trend between citizens' confidence towards European and national institutions after the

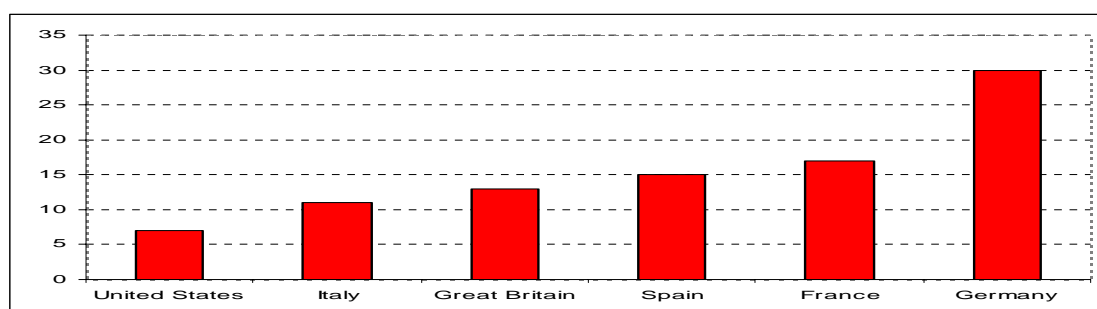
⁷ Data on the confidence towards national institutions from the Standard EB 71 have not even been published in the analytical summary on the Eurobarometer European Parliament (Eurobarometer, 2009a). The data from autumn 2008 (Standard EB 70) have only been released for the aggregated values for the EU27 (Eurobarometer 2009b). Thus one has to wait for the publication of the data from the Standard EB 71 to evaluate the trend of the net trust levels towards national institutions.

financial crisis. The data sets of the upcoming standard Eurobarometers 71 and 72 have to be examined once they are available to shed more light on the confidence trend towards national institutions.

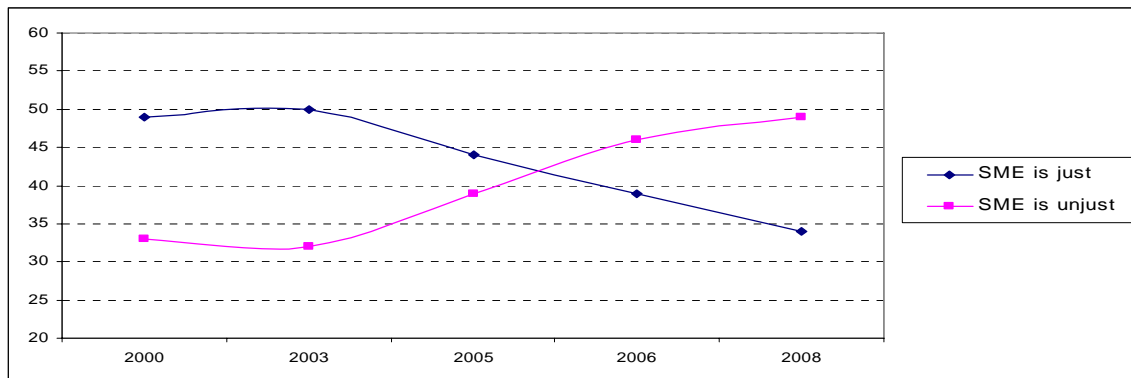
4. The effect of the financial crisis on citizens' confidence in the market economy

A certain level of citizens' confidence in market-based economies is crucial for the maintenance of social peace and the stability of the economic system. It guarantees citizens' support of an economic system in which the means of production are privately owned and operated for profit through of free market mechanisms. According to the results of an FT-Harris poll, as depicted in Figure 7, the level of confidence towards capitalistic free market economies is distributed differently throughout the different European countries and the US. When asked in October, directly after the beginning of the financial crisis whether the current financial crisis had been caused more by "abuses of capitalism" or by the "failure of capitalism itself", an astonishing 30% of German respondents selected the latter explanation. This value is four times higher than the 7% obtained in the US and nearly twice as high as that obtained in France, at 17%. These strong German anti-capitalist sentiments are accompanied by a significant increase in discontent expressed by German citizens with the concept of a social market economy. Figure 8 shows the German trend data (Institut für Demoskopie Allensbach, 2008) towards trust in the social market economy. From 2003 until November 2008, there was a significantly steady increase in the number of German citizens who thought that the social market economy was unjust, by a clear majority of 49% vs. 34% after the financial crisis in November 2008. This increase in German citizens' discontent with the social market economy is also supported by time trend data and a poll conducted by the Bertelsmann Stiftung (2008) in May 2008, which found that 73% of German citizens evaluated the income distribution in Germany as unfair. Similarly, according to the WIN Crisis Index (2009) conducted in January 2009, German citizens have one of the lowest confidence levels towards banks, stock markets and their government compared to other G20 countries. However, these results could merely reflect the fact that the German economy has been hit the hardest among the world's largest economies by the financial crisis with an expected decrease of economic growth by a staggering 6%. Thus German citizens might have been aware of this fact from the earliest stages of the financial crisis.

Figure 7. Abuse or failure of capitalism? – Anti-capitalist tendencies among G8 countries



Data source: FT-Harris Poll (2008).

Figure 8. German social market economy – Socially just versus unjust

Data source: Institut für Demoskopie Allensbach (2008).

5. Conclusion

As could be presumed, the financial crisis had a significant impact on the levels of trust that citizens place in the system and its institutions. Recent data show a significant fall in the confidence of European citizens' in the EU's institutions. This sharp decline of confidence can be best observed in the case of the European Central Bank. For the first time since its creation, a majority of European citizens no longer trusts the ECB.

However, the significant decrease in European citizen's confidence towards the two other European institutions – the European Commission and the European Parliament – is not replicated at the national level. Two independent data sources highlight that confidence levels in national governments have actually risen supporting a contrasting trend between the confidence in European and national institutions. It remains to be seen whether or not this first indication points towards a new trend of re-nationalisation. However, one can clearly observe that the level of trust in the European institutions remains much higher than that for national institutions, but the advantage enjoyed by 'Europe' has been significantly reduced.

This decrease in confidence towards the ECB is flanked in the case of Germany by strong anti-capitalist sentiments and a sharp decline in support for the social market economy, with 30% of Germans identifying the current financial crisis as a failure of capitalism and around 50% characterising the social market economy as unjust, compared to around 35% who still identify it as just.

One now has to wait for the release of the forthcoming data from Standard Eurobarometers 71 and 72, which will further help to more precisely evaluate the effects of the financial crisis on levels of systemic trust towards European and national institutions.

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